

BEFORE THE STATE BOARD OF EQUALIZATION
'OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
RONALD LEE ROYER)

For Appellant: Irwin Siegel
 Attorney at Law

For Respondent:, Bruce W. Walker
 Chief Counsel

Paul J. Petrozzi
Counsel

O P I N I O N

This appeal is made pursuant to sections 18646 and 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the petition of Ronald Lee Royer for reassessment of jeopardy assessments of additional personal income tax in the amounts of \$3,359.00 and \$1,929.00 for the years 1973 and 1974, respectively.

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The following sequence of events form the basis for the jeopardy assessments against appellant:

1. On 'August 6, 1973, under the authority of a search warrant,' police officers entered appellant's home and **seized** cash in the amount of \$1,902.00, and drugs having a wholesale value of \$9,781.00.

2. On August 22, 1973, appellant was arrested, apparently in connection with the above seizure of illegal drugs. In his possession was \$1,900.00 in cash, which was seized.

3. On July 5, 1974, appellant was arrested in connection with other drug charges. At that time, police seized \$717.00 in cash, and drugs having a wholesale value of \$1,685.00.

4. On February 4, 1975, appellant pled guilty to a violation of, section 11359 of the Health and Safety Code, i.e., possession of marijuana for sale.

The above described arrests and seizures followed several months of drug purchases by undercover narcotics officers from one of appellant's associates. Appellant did not participate directly in these sales, **but at least one buy took place at appellant's residence and a vehicle used in the buys was traced to appellant.**

After **learning of these** events, respondent issued the jeopardy assessment in question and collected \$4,519.00 in cash, under notice served pursuant to section 18817 of the Revenue and Taxation Code.

Appellant petitioned for a reassessment, submitting two different Statement of Financial Condition forms (Form FTB 3860 (3-68)), one dated October 4, 1973, and the other dated August 9, 1974. On these respective forms appellant stated his income and expenses as **follows:**

	<u>1973</u>	<u>1974</u>
Income	\$7,000 gambling	
Monthly expenses	\$1,425	\$72;
Purchases	\$4,377 Cadillac	0
	\$1,200 antiques	

In **his** presentence interview appellant also declared that **he** had **earned** \$10,000 per year since 1971 selling antiques and was a "small operator" in narcotics traffic.

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(See Probation Officer's Report, Case No. A069506, dated February 19, 1975, Los Angeles County Superior Court.) Appellant kept no records of cash receipts and disbursements, nor did he file returns for the taxable years in issue.

Respondent denied appellant's petition for reassessment and this appeal followed. The principal issue on appeal is whether respondent reasonably reconstructed appellant's income.

When a taxpayer does not maintain adequate accounting records, respondent may reconstruct his income by whatever method will, in its opinion, clearly reflect income. (Rev. & Tax. Code, § 17561, subd. (b); Cal. Admin. Code, reg. 17561, subd. (b) (1).) Further, if a taxpayer fails to file a return, respondent may make an estimate of his net income from any available information, and assess the tax due. (Rev. & Tax. Code, § 18648, subd. (a).) It is not necessary that mathematical exactness be achieved (Harold E. Harbin, 40 T.C. 373), but the reconstruction will be presumed correct only if it is reasonable and is based on assumptions which are supported by the evidence. (Shades Ridge Holding Co., Inc., ¶64,275 P-H Memo. T.C. (1964), affd. sub nom., Fiorella v. Commissioner, 361 F.2d 326 (5th Cir. 1966); Appeal of David Leon Rose, Cal. St. Bd. of Equal., March 8, 1976.) Appellant has the burden of proving that respondent's computation was incorrect (Breland v. United States, 323 F.2d 492 (5th Cir. 1963)), and that the correct income is an amount less than that on which the deficiency assessment was based. (Kenney v. Commissioner, 111 F.2d 374 (5th Cir. 1940).)

Respondent gathered a substantial amount of information concerning appellant's alleged income and expenses for the taxable years 1973 and 1974. The source of most of this information was appellant himself. Other figures used in respondent's calculations were estimates based on appellant's involvement in drug traffic. In contrast to previous drug sale cases where a so-called projection method was used to reconstruct the taxpayer's income, here respondent chose to employ the traditional net worth and cash expenditures methods, which does not focus on drug sales but considers overall income and expenses. The choice of a particular method is discretionary but where the net worth method or one of its variants such as the excess cash expenditures method is used, certain proof requirements apply. Principal among these is the determination "with reasonable certainty"

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of appellant's net worth or cash on hand at the beginning of each taxable year "as a starting point from which to calculate further increases in the taxpayer's assets" or the extent to which expenditures exceed income. (Holland v. United States, 348 U.S. 121, 132 [99 L.Ed. 150] (1954).)

Respondent's determination of appellant's opening net worth for the taxable years 1973 and 1974 was based on the assumption that certain property found in appellant's possession was purchased with taxable income earned during those same years. This determination may be imprecise, but in the absence of records, some assumptions must be made and it is necessary only that they be based on available facts rather than conjecture. (Appeal of Burr McFarland Lyons, Cal. St. Bd. of Equal., Dec. 15, 1976.) By his own admission, appellant earned \$10,000 in 1972. During that same year, appellant was supporting four other persons, including his three children. While appellant submitted no information detailing his total expenses for 1972, under these same factual circumstances in 1973 and 1974, appellant's living expenses alone exceeded his claimed income in one year and very nearly equaled it in the next. If we accept appellant's information as being true, and no reason appears why it is not credible, then it is not unreasonable to assume that appellant began the taxable years 1973 and 1974 with virtually no savings and must have acquired taxable income in those years simply to meet his claimed living expenses.

As previously stated, appellant has the burden of proving that the assessment herein is erroneous and he must prove this by a preponderance of evidence. (Kubik v. United States, 31 Am. Fed. Tax R.2d 73-754 (1972).) All that appellant has stated is that he had unreported taxable income in 1973 and 1974 of at least \$17,000 and \$10,000 respectively. And although appellant did not report income from drug sales under the circumstances it is not unreasonable to include in an estimate of his income the value of large-quantities of drugs found in his possession on two separate occasions. But for the seizure of these drugs upon his arrest, appellant probably would have derived income from their sale. (See Appeal of John and Codelle Perez, Cal. St. Bd. of Equal., Feb. 16, 1971.) However, because the record indicates that appellant's associate customarily received one-half the profits from completed sales, we believe respondent's estimate should reflect this distribution and should therefore be modified accordingly. (See Appeal of David Leon Rose, supra.)

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We acknowledge that the evidence in this case is largely circumstantial, but it is not necessary that respondent eliminate all doubt from its determination, particularly where any speculation results from appellant's failure to provide evidence from which a better computation can be made. (Appeal of David Leon Rose, supra.) Here, it is apparent that appellant had a likely source of income either through narcotics traffic or antique sales and gambling as appellant alleges. Further, appellant has not offered any reasonable explanations which would indicate that his income was from nontaxable sources, such as gifts or savings. (Holland v. United States, supra; United States v. Massei, 355 U.S. 595 [2 L. Ed. 2d 517] (1958).)

In the Appeal of David Leon Rose, supra, we cited the following statement of the Tax Court in Shades Ridge Holding Co., Inc., supra:

Admittedly there are gaps in the evidence and our conclusions are at best approximations based on assumptions we have gleaned from the evidence we do have, and unfortunately do not rest entirely on proven facts as we would prefer, but it is our obligation to redetermine the correct amount of tax from what evidence is presented to us, and that we have done. Our only alternatives would be to affirm respondent's determination on the presumption of correctness that attaches thereto, which we do not think would be just [citation], or to make a finding of no deficiency because of lack of sufficient evidence to make an exact determination. To do that would be "tantamount to holding that skillful concealment is an invincible barrier to proof," [citation] and to reward the person who deliberately refuses to keep records as required by law. [Citations.] (1964 P-H T.C. Memo., at p. 64-1837.)

For the above reasons we conclude that respondent's reconstruction of appellant's income should be modified to attribute to appellant only one-half the value of the drugs seized in each taxable year. In all other respects, the reconstruction is sustained.

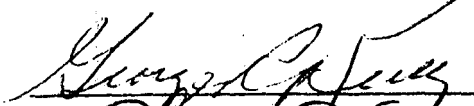
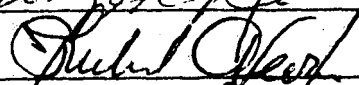
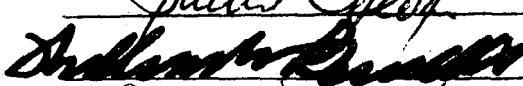

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O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the petition of Ronald Lee Royer for reassessment of jeopardy assessments of additional personal income tax in the amounts of \$3,359.00 and \$1,929.00 for the years 1973 and 1974, respectively, be and the same is hereby modified to reflect the attribution to appellant of 'one-half the value of the drugs seized. In all other respects, the action of respondent is sustained.

Done at Sacramento, California, this 26th day of July, 1978, by the State Board of Equalization.


_____, Chairman

_____, Member

_____, Member

_____, Member
_____, Member